

MULTIMEDIA



UNIVERSITY

STUDENT ID NO

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MULTIMEDIA UNIVERSITY

FINAL EXAMINATION

TRIMESTER 3, 2017/2018

BAC1644 – PRINCIPLES OF FINANCE

(All sections / Groups)

31 MAY 2018
9.00a.m - 12.00p.m
(3 Hours)

INSTRUCTIONS TO STUDENTS

1. This question paper consists of **FOUR (4)** printed pages.
2. Answer **ALL** questions.
3. Marks are shown at the end of each question.

Question 1 (25 Marks)

- a) Discuss the roles of financial manager in maximizing shareholders' wealth. (6 marks)
- b) Consider the following information on a portfolio of three stocks:

State of the economy	Probability of State of Economy	Stock A Rate of Return	Stock B Rate of Return	Stock C Rate of Return
Boom	0.15	.05	0.21	0.18
Normal	0.80	.08	0.15	0.07
Bust	0.05	.12	0.22	-0.02

The portfolio is invested 35 percent in each Stock A and Stock B and 30 percent in Stock C. If the expected T-bill rate is 3.90 percent, what is the expected risk premium on the portfolio?

(14 marks)

- c) You own a stock that has an expected return of 16.00 percent and a beta of 1.33. The U.S. Treasury bill is yielding 3.65 percent and the inflation rate is 2.95 percent. What is the expected rate of return on the market?

(5 marks)

Question 2 (25 Marks)

- a) Explain why a firm might prefer a stock repurchase rather than an increase in the firm's regular dividend. (9 marks)
- b) The forecasted sales volume of your Kerepek products from year1 to year 4 are as given in the table. The sales price at year 0 is RM 4, prepare the demand and costs associated with the products.

Year	1	2	3	4
Demand (Units)	700	800	900	1500
Variable cost (RM per box)	2	3	3	3.5
Total fixed costs (RM)	100	180	280	380

Continued...

The production equipment for the new product line would cost RM2000 and an additional initial investment of RM750 would be needed for working capital. Capital allowances (tax-allowable depreciation) on a 25% reducing balance basis could be claimed on the cost of equipment. Profit tax of 30% per year will be payable one year in arrears. A balancing allowance would be claimed in the fourth year of operation. The average general level of inflation is expected to be 3% per year and selling price, variable costs, fixed costs and working capital would all experience inflation of this level (nominal after-tax cost of capital is 12%).

Required:

Assuming that production only lasts for four years, calculate the net present value of investing in the new product using a nominal terms approach and advice on its financial acceptability.

(16 marks)

Question 3 (20 Marks)

a) You are given the following information concerning Aydan Corporation:

Information on Bond:

Debt: 8,500 bonds with par value of 1000, 7.1 percent coupon bonds outstanding with 14 years to maturity and a market price of the bond is RM 1026. These bonds pay interest semiannually.

Information on Common stock:

Common stock: 265,000 shares of common stock selling for RM76 per share. The stock has a beta of 0.92 and will pay a dividend of RM2.48 next year. The dividend is expected to grow by 4 percent per year indefinitely.

Information on Preferred stock:

Preferred stock: 7,500 shares of 6 percent preferred stock selling at RM88 per share.

Calculate the weighted average cost of capital (WACC) for this firm. Tax rate is 34 percent.

(12 marks)

Continued...

- b) Aysha Corporation just paid its annual dividend of RM 1.40. The required return is 8 percent and the dividend growth rate is 1 percent. What is the expected value of this stock five years from now?

(4 marks)

- c) This morning, you purchased a stock that will pay an annual dividend of RM1.90 per share next year. You require a 12 percent rate of return and the annual dividend increases at 3.5 percent annually. What will your capital gain be on this stock if you sell it three years from now?

(4 marks)

- d) Explain why some bonds sell at a premium over par value while other bonds sell at discounts. What do you know about the relationship between coupon rate and the yield to maturity (YTM) for premium bonds, discounts and at par value bonds?

(5 marks)

Question 4 (20 Marks)

- a) Discuss the reason for holding cash and the effect of holding too much cash.

(9 marks)

- b) Smelly Perfumes sells 3,500 units of its perfume collection each year at a price per unit of RM275. All sales are on credit with terms of 1/7, net 30. The discount is taken by 40 percent of the customers. What is the amount of the company's accounts receivable?

(5 marks)

- c) Rock Bottom Carpets sells 5,600 carpets a year at an average price per carpet of RM 1,490. The carrying cost per unit is RM22.37. The company orders 500 carpets at a time and has a fixed order cost of RM69 per order. The carpets are sold out before they are restocked. What is the economic order quantity?

(5 marks)

Continued...

- d) Appalachian Mountain Goods has paid increasing dividends of RM0.12, RM0.18, RM0.20, and RM0.25 a share over the past four years, respectively. The firm estimates that future increases in its dividends will be equal to the arithmetic average growth rate over these past four years. The stock is currently selling for RM12.60 a share. The risk-free rate is 3.2 percent and the market risk premium is 9.1 percent. What is the cost of equity for this firm if its beta is 1.26?

(6 marks)

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